United Nations A/CONF.198/6

International Conference on Financing for Development

Monterrey, Mexico
18-22 March 2002

Distr.: General
6 March 2002

Original: English

Items 9 and 10 of the provisional agenda*

Ministerial segment

Summit segment of the provisional agenda

Letter dated 5 March 2002 from the Chargé d'affaires of the Permanent Mission of Mexico to the United Nations and the Permanent Representative of Norway to the United Nations addressed to the Secretary-General

The Governments of Mexico and Norway, the Inter-American Development Bank and the Group of 24 co-sponsored a conference on the theme "Financing for development: regional challenges and the regional development banks" and a round table on the theme "New proposals on financing for development" in Washington, D.C., on 19 and 20 February 2002.

The conference and round table were organized by the Centre for Global Development and the Institute for International Economics in support of the International Conference on Financing for Development, to be held in Monterrey, Mexico, from 18 to 22 March 2002.

We have the honour to transmit the attached Chairperson's report of the outcomes of the conference and round table (see annex). The report has been prepared by the Chairpersons of the two events. It does not necessarily represent the views of the Mexican and Norwegian Governments.

Upon instruction from our Governments, we have the honour to request that the present letter and its annex be circulated as a document of the International Conference on Financing for Development.

(*Signed*) Roberta **Lajous**
Ambassador
Chargé d'affaires a.i.
Permanent Mission of Mexico to the United Nations

(*Signed*) Ole Peter **Kolby**
Ambassador
Permanent Representative of Norway to the United Nations

* A/CONF.198/1.

02-27487 (E) 280202

Annex to the letter dated 5 March 2002 from the Chargé d'affaires of the Permanent Mission of Mexico and the Permanent Representative of Norway addressed to the Secretary-General

New Proposals and Regional Challenges on Financing for Development

Chairpersons' Report*

By
The Center for Global Development and
The Institute for International Economics

On February 19 and 20, 2002, the Center for Global Development (CGD), and the Institute for International Economics (IIE) organized in Washington, D.C. two interrelated events aimed at providing ideas and input for the UN Global Conference on Finance for Development (FfD) in Monterrey, Mexico. The first event was a conference on ***Financing for Development: Regional Challenges and the Regional Development Banks***. The second was a high-level round-table on ***New Proposals on Financing for Development***. The Government of Norway, the Mexican Government, the Inter-American Development Bank, and the Group of 24 co-sponsored these events. Participants included a small number of ministers of finance, central bank governors and ministers of development from around the world as well as several leading policy and academic experts who held informal and frank interaction during the two-days meetings. This reports conveys observations and conclusions from their discussions.

The goal of the meetings was two-fold: first to identify initiatives to expand financial resources available for development that merit serious consideration at the political level in Monterrey; and second to address regional cooperation and the specific role of Regional Development Banks (RDBs), an issue largely overlooked by the Preparatory Committee for Monterrey.

The main conclusion from the meetings was that the ambitious Millennium Development goals can only be achieved through a combination of increased financial flows to developing countries, and increased effectiveness of those flows in triggering growth and poverty reduction. That in turn implies not only more foreign aid but increased private investment, domestic and foreign. Conference participants

* The meetings were chaired by the President of the Center for Global Development, Nancy Birdsall, and the Director of the Institute for international Economics, Fred Bergsten. This report is available on the website of the Center for Global Development, www.cgdev.org.

agreed that the potential contribution of RDBs, particularly in catalyzing greater private flows, and in helping borrowers acquire more sustained and less costly access to global markets, has not been fully exploited.

1. Aid as a Source of Finance

Aid efficiency

While there are deficiencies in aid delivery and development policies that need to be addressed, there is a broad consensus that aid programs can work and that increased official development assistance (ODA) is essential for the achievement of the Millennium Development Goals. Aid is not sufficient, but it plays an indispensable role. The Zedillo report (later confirmed by a World Bank report) estimates that an additional US$50 billion per year is needed to reach the goals. At the same time, the report emphasizes that prudent and efficient policies in the developing countries, and reforms in the donors' mechanisms for delivering aid, are necessary for the effectiveness of ODA. The challenge is both an increase in aid, and the need for improving the efficiency of ODA that already exists.

A number of conference participants provided examples about channels of aid that do work and argued that a significant increase of aid funds can easily be put to good use. They argued that in the areas of health and education alone donor countries could double the amount of money that they are spending today and know that they are spending it well. Important and well-designed programs like the *Global Disease Fund* and WHO's *Stop TB Partnership* are starved for lack of funds. The WHO Commission chaired by Jeffrey Sachs, *Macroeconomics and Health* shows that improved health can have a large impact on development.

Performance monitoring

A consensus exists about the need for close monitoring of the results of development policies and that aid should be linked to performance. Donors and developing countries owe it both to the world's poor and to the taxpayers to make sure that aid money is used wisely. The developed countries should focus on the volume and quality of assistance, market access, and on enhancing the representation and participation of developing countries in multilateral organizations. The developing countries should focus upon the whole range of domestic preconditions that are needed for development, i.e., on good governance in the broadest sense of the term. Several participants also focused on the responsibility of donor countries in making and keeping their commitments to poor countries.

> We have been involved in the structural adjustment programs, we have liberalized, we have opened our economy, the Uganda Shilling is freely convertible, and so on. I have said to the IMF, "Look, you are a doctor, and I have attended to the prescription that you gave me, and I have behaved as is to be expected, but still I am not seeing a light at the end of the tunnel."
>
> *Gerald Ssenduala, Minister of Finance, Uganda*

Grants or concessional lending?

There is broad agreement that many development concerns need to be financed by grants, and that some countries have unsustainable debt levels. Participants agreed in principle that some share of World Bank concessional resources ought to be used as grants. There was general agreement that IDA resources for certain needs such as post-conflict reconstruction, natural disasters, HIV/AIDS and other infectious diseases should be disbursed in grant form. But there was no real progress on the existing debate between the Americans and the Europeans on the proportion (anywhere from 10 to 50%) that should be directed towards grants. A number of ministers argued that focus should be on the need for increased funding, not on shifting funds between channels.

> There is a charitable spirit in the United States that will be more forthcoming than the current level of assistance that's provided through the federal government, but I don't think it will be real until we can do a better job of demonstrating value for money spent.
>
> *Paul O'Neill*
> *U.S. Secretary of the Treasury*

Exchange of views during the meetings showed that the disagreement between the US and the European donors is not really on some arbitrary number for the share of grants in World Bank disbursements. Instead, the central issue is a perceived difference in the willingness to commit funds for increased development aid. Some conference participants suggested that a possible compromise may be the Gordon Brown proposal for an agreement where donors declare a long-term commitment to increase funds provided that the developing countries pledge to good governance and where aid disbursements depend on results demonstrated on the ground.

> ODA is where we have come up short. ODA is where Monterrey must urgently move beyond the Monterrey consensus reached in New York. We owe it to ourselves, as well as to our development partners, to constantly strive for greater development effectiveness. But just improving quality cannot resolve the problem of under-funding in our development efforts.
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> *Hilde Frafjord Johnson*
> *Minster of International Development, Norway*

2. New financing initiatives

A number of new initiatives dealing with the scarcity of funds for development emphasize collective actions between countries as superior alternatives relative to decisions at the country level. At the meetings, Nobel Prize winner Joseph Stiglitz argued that cooperation between countries to form a pool of shared foreign reserves would reduce significantly the high opportunity cost of holding reserves by each country separately. In Stiglitz's view, this cooperative approach would allow countries to free up resources for development.

The creation of a new source of funding at the global level is also at the core of George Soros' proposal. Soros advanced a new mechanism for allocating the newly proposed issue of Special Drawing Rights (SDRs) by the International Monetary Fund (currently waiting approval by the US Congress). Soros proposed that industrial countries donate their share of SDRs to developing countries. Resources transferred would be used to finance development projects, such as those related to education and health, in a "market place of projects." Use of these resources would follow clear conditions and would be monitored by a board of experts fully independent of the IMF.

Advantages and limitations of these proposals were discussed at the meetings. For example those against Soros' proposal argued that the immediate use of SDRs allocations would involve a creation of money that could generate world wide inflationary pressures. Others disliked the idea of using funds aimed at dealing with liquidity problems to finance long-term projects. Not surprisingly, supporters of the proposal considered the benefits of additional resources for financing as largely exceeding the associated risks.

3. Instruments and policies to attract foreign private capital

While participants recognized that foreign private capital cannot meet all development needs, sustained access to international capital markets is of utmost importance to most developing countries because they require higher investment than their current savings. The goals of official aid cannot be reached without complementary sources of private sector finance. Conference participants agreed that improving market access involved important efforts by developing countries. Ministers from both developing and industrial countries agreed that long-term private investment can only occur in an environment where the economic fundamentals are stable, property rights are clearly defined and the rule of law is adequately enforced. In this regard, the role of RDBs was highlighted. Because of their deep knowledge of the economic and political circumstances of a region, RDBs were viewed as unusually well positioned to help countries advance these second generation reforms needed to attract private investment.

Participants discussed the merits and problems of implementing in developing countries the international standards and codes being developed by the Basle Committee. There was agreement about the ultimate usefulness of the standards in enhancing the role of market discipline, and, therefore, improving countries' access to international capital markets. But most participants were concerned that immediate and full compliance with standards that do not take into account the shallow financial markets in many developing countries (and in some settings the high and unpredictable risks of domestic government debt), did not make sense. In addition, compliance with the standards was too expensive for most developing

countries. From the perspective of developing countries the following problems were raised: (a) an excessive number of standards; (b) insufficient resources and technical capacity for implementing the standards (c) lack of ownership, i.e. the developing countries have no real participation in the design and prioritization of standards.

Recognizing these problems, participants saw a key role for the RDBs to bridge the gap between standard-assessing institutions (largely, the IMF and the World Bank) and developing countries. Participants identified three instruments at the disposal of RDBs: their own lending, especially financial sector reform loans; their convening power, particularly with the private sector; and their technical assistance capacity.

More generally, with these instruments, and with their capacity (though relatively limited by their own policies, except in the case of the EBRD) to provide direct loans and guarantees to the private sector to catalyze private flows, the RDBs can help countries improve their own financial markets, promote the development of regional capital markets, and facilitate access to the international financial markets, using their own expertise and contacts in those markets on behalf of their members. Finally, they may be able to help limit regional contagion from national financial crises by creating and disseminating to the global capital markets a constant stream of information about country policies and institutions, allowing the markets to differentiate within regions.

The provision of "emergency liquidity loans" by RDBs at time of financial crises was more controversial. Some participants agreed that this was a role for the IMF only. Others noted that during recent crises, RDBs have played a critical role in providing short-term budget support for sustaining and rebuilding the medium-term countercyclical social safety programs that are a central development challenge.

4. Regionalism: the sleeping giant in mobilizing financing sources for development

Discussions brought consensus about the benefits of regional trade and financial integration. Because trade agreements are conducive to growth, they allow for the creation of resources that can be allocated to development goals. Moreover, reciprocal opening of markets for goods and financial services provides opportunities for foreign direct investment and its related fresh inflow of long-term capital. Participants viewed regional integration as a complement, rather than a substitute, to development of more integrated global markets. Regionalism has helped advance multilateral negotiations. The experience of the European Union was cited as a case in point, especially in generating "peer pressure" that can help the regions to help themselves.

A number of participants argued that regional integration is itself a regional public good. Regional efforts are constrained by the difficulty of coordination, or collective action, among countries. The public goods dimension of regional integration calls for the support of RDBs. These institutions can provide the intellectual leadership to promote regionalism. RDBs can also help countries build the necessary capacity to meet the challenges of regionalism. This includes reforms in labor and capital markets, establishment of needed infrastructure and regulatory base to compete effectively in the international arena and the provision of social safety nets to minimize the impact of resource re-allocation on the poor.

But regionalism goes beyond trade and financial agreements. It also includes the provision of regional public goods and services essential for development that are not provided by markets or by single nations. In spite of their importance, there is under-investment in many key regional public goods. Returns would be high to new regional investments in trans-border infrastructure, programs to contain contagious disease, watershed management, and management of such regional 'bads' as environmental spillovers.

Major regional initiatives such as the New Partnership for Africa's Development (NEPAD) and efforts to deal with shared natural resources like the Nile River Basin Initiative or the Mekong River Commission are important, not only for the development of the participating countries, but are also essential instruments for preventing and solving conflicts, a prerequisite for development. However, they are difficult both to organize and to finance.

Once again, RDBs are well placed to serve as catalysts for collective action. Because of cultural proximity and the borrowers' role in the management of the banks, RDBs have the capacity to convene, generate and transfer knowledge, assist in negotiations, and transfer funding – especially to support regional initiatives themselves. By involving themselves in these activities, RDBs have the ability to lock countries into reform commitments and create venues where parties can meet to address negative neighborhood problems. At the moment, however, the RDBs lack an instrument, other than grants, to finance regional goods since their loans require recipient government guarantees, and the allocation of the benefits of regional goods across borrowers is problematic.

5. Increasing Domestic Savings: A Sustainable Source of Financing for Development

Throughout the discussions it became apparent that participants agreed on the need for developing countries to build up their own sources of finance. This is particularly important given the well-known volatility of international private capital flows. While it was recognized that achieving ratios of domestic savings consistent with sustainable growth and development was a long-term objective, a number of participants emphasized the need to build the foundations to reach such a goal. In this connection, participants stressed the importance of sound banking systems and the development of domestic capital markets. Well functioning domestic financial systems are essential to create incentives for depositors to maintain their savings in long-term instruments and to ensure the productive allocation of these savings. In short, while foreign aid is essential to bridge the existing colossal gap between needed investments and current domestic savings, a measure of aid's success will ultimately be in the capacity of developing countries to generate domestic savings.